

Message Text

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ACTION EUR-25

INFO OCT-01 EA-11 ISO-00 AID-20 CEA-02 CIAE-00 COME-00

EB-11 FRB-02 INR-10 IO-14 NEA-14 NSAE-00 RSC-01

OPIC-12 SP-03 TRSE-00 CIEP-02 LAB-06 SIL-01 SWF-02

OMB-01 PA-04 PRS-01 USIA-15 DRC-01 /159 W

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R 091650Z JUL 74

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INFO AMEMBASSY TOKYO

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E.O. 11652: N/A

TAGS: ECON, OECD

SUBJECT: EDRC ANNUAL REVIEW OF JAPAN, JUNE 28

REF: (A) USOECD 13971, (B) TOKYO 8555, (C) OECD DOC
EDR (74)21

1. SUMMARY: JAPAN REJECTED SECRETARIAT THESIS THAT SOME RELAXATION OF PRESENT RESTRICTIVE POLICY STANCE MAY BE NECESSARY LATER IN YEAR IF ECONOMIC RECOVERY IS TO OCCUR EARLY IN 1975. JAPAN CONSIDERS RESTRICTIVE MEASURES ESSENTIAL TO COMBAT INFLATION, AND BELIEVES PRESENT LEVEL OF RESTRAINT WILL NOT PREVENT RECOVERY FROM GAINING MOMENTUM. JAPAN SEES GNP GROWTH SLIGHTLY MORE FAVORABLE THAN SECRETARIAT ESTIMATE OF MINUS 1.5 PERCENT IN 1974, AND EXPECTS CPI TO RISE BY 25 PERCENT. BOP TRADE ACCOUNT EXPECTED REGAIN EQUILIBRIUM EARLY IN 1975 DUE TO IMPROVEMENT IN EXPORTS TO OPEC AND COMMUNIST COUNTRIES. END SUMMARY.

2. OUTLOOK FOR GROWTH AND DEMAND. JAPAN AND SECRETARIAT VIRTUALLY AGREED ON GROWTH FORECASTS FOR 1974-II
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(4.5 PERCENT) AND 1975-I (7.5 PERCENT), BUT DIFFER

REGARDING POLICY MEASURES NEEDED TO ACHIEVE THEM. MAIN DIFFERENCE IS IN PERCEPTION OF UNDERLYING STRENGTH OF DEMAND AND POLICIES NEEDED TO MANAGE IT. SECRETARIAT SEES POSSIBILITY OF RECOVERY IN CONSUMER DEMAND AND INVESTMENT IN SECOND HALF 1974 PROVIDED THAT JAPAN TAKES SELECTIVE MEASURES TO EASE CURRENT MONETARY AND FISCAL TIGHTNESS. JAPANESE DEL (MIYAZAKI) ARGUED THAT ANY RELAXATION OF CREDIT CONTROLS, OR EASING OF ADMINISTRATIVE GUIDELINES ON INVESTMENT, OR RISE IN PUBLIC EXPENDITURES, WOULD HAVE ADVERSE EFFECT ON INFLATION WHILE PENT UP DEMAND FOR INVESTMENT AND PRIVATE CONSUMPTION IS STILL STRONG AND SOME PRODUCTION BOTTLENECKS REMAIN. HE DID NOT SEE DANGER OF RECESSION IF PRESENT LEVEL OF RESTRAINT MAINTAINED. HE WAS SATISFIED THAT PROSPECTS FOR DEMAND WERE SUFFICIENT TO PERMIT GRADUAL RISING MOMENTUM OF RECOVERY. (NB: JAPAN SEES 5-7 PERCENT REAL GROWTH OF GNP FOR FULL YEAR 1975.)

3. EXAMINING COUNTRIES (UK AND FRANCE) EXPRESSED CONSIDERABLE DOUBT ABOUT STRENGTH OF FORCES FOR RECOVERY, NOTING THAT LITTLE STIMULUS WAS EXPECTED IN SECRETARIAT FORECASTS FOR PRIVATE RESIDENTIAL OR NON-RESIDENTIAL INVESTMENT; THAT PUBLIC EXPENDITURE WOULD REMAIN FROZEN; AND THAT STIMULUS TO CONSUMER SPENDING IN REAL TERMS WOULD BE VERY SMALL. IN REPLY, JAPAN NOTED STRONG INVESTMENT INTENTIONS OF PRIVATE BUSINESS IN RESPONSE TO CAPACITY SHORTAGES, AND RECENT 32 PERCENT INCREASE IN NOMINAL WAGES. SECRETARIAT AND AUSTRALIA SUGGESTED THAT RESTRICTIVE MONETARY POLICY MIGHT DAMPEN INVESTMENT OUTLOOK THROUGH HIGH COST OF BORROWING AND CREDIT CONTROLS, PREVENTING RESOLUTION OF CAPACITY CONSTRAINTS. IN FINAL ANALYSIS, SECRETARIAT ADMITTED THAT JAPAN MIGHT STILL BE ABLE TO ACHIEVE GROWTH TARGETS WITHOUT SIGNIFICANT RELAXATION OF POLICY IF STRONG FOREIGN DEMAND MADE UP FOR SLACK DOMESTIC CONDITIONS. THIS WOULD NOT, HOWEVER, RESOLVE SECRETARIAT'S CONCERN REGARDING ADVERSE INTERNATIONAL IMPACT OF IMPROVEMENT IN JAPANESE CURRENT ACCOUNT POSITION, AND FOR THIS REASON ALONE IT WAS LIMITED OFFICIAL USE

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IMPORTANT TO ALLOW DOMESTIC DEMAND TO RISE AT REASONABLE RATE.

4. OUTLOOK FOR INFLATION: JAPAN CONTINUES TO BELIEVE THAT CONTROL OVER INFLATION IS NUMBER ONE PRIORITY. THEY EXPECT 25 PERCENT CPI RISE IN 1974 WITH ANNUAL RATE OF INCREASE DROPPING STEADILY TO 20 PERCENT BY DECEMBER AND TO 12 OR 13 PERCENT BY MARCH 1975. (FOR

FULL YEAR 1975, CPI EXPECTED RISE ABOUT 10 PERCENT.)
JAPANESE NOTED THEIR PRICE POLICY DEPENDS LARGELY ON
DEMAND MANAGEMENT, AND THEY AGREED WITH RECENT
EPC CONCLUSION THAT PROLONGED PERIOD OF RESTRAINT MAY
BE NECESSARY. THEY ALSO WILL ALLOW INCREASED IMPORTS
TO FILL DOMESTIC SUPPLY GAPS, AND WILL MAINTAIN PRICE
CONTROL ON CERTAIN PRODUCTS. REGARDING POSSIBLE

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OMB-01 PA-04 PRS-01 USIA-15 DRC-01 /159 W

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PRICE AND INCOMES POLICIES, JAPANESE NOTED IN SAME
BREATH THAT THEY HAD NO INTENTIONS OF INTRODUCING ANY
KIND OF INCOMES POLICY BUT IN VIEW DAMAGING EFFECTS
OF CONTINUED HIGH WAGE INCREASES, THEY WOULD BE MAKING
CAREFUL STUDY OF RELATION BETWEEN WAGES, PRICES AND
GROWTH. IN 1974-II, THEY NOTED WAGE COSTS WOULD CON-
TRIBUTE ALMOST 80 PERCENT OF EXPECTED PRICE RISE.

5. BALANCE OF PAYMENTS: JAPANESE NOTED THAT MAIN
OBJECT OF RESTRICTIVE MONETARY POLICY WAS TO COMBAT
DOMESTIC INFLATION, BUT THEY ALSO HOPED FOR SOME RE-

DUCTION IN CURRENT ACCOUNT DEFICIT AS BY-PRODUCT. CA
DEFICIT EXPECTED TO BE \$7 BILLION IN 1974, BUT SLUGGISH
DOMESTIC DEMAND MAY CAUSE LOWER IMPORTS AND HIGHER EX-
PORTS THAN ANTICIPATED. CAPITAL ACCOUNT WILL IMPROVE
SIGNIFICANTLY FROM 1973 DEFICIT OF \$10 BILLION, AND
JAPAN DOES NOT SEE NEED FOR BOP FINANCING.

6. TRADE BALANCE SEEN DETERIORATING BY \$5.3 BILLION
OVER 1973 LEVEL, LARGELY DUE TO \$12.2 BILLION EXTRA
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OIL COSTS. HOWEVER, NON-OIL BALANCE SEEN IMPROVING
BY \$7 BILLION SINCE EXPORT VOLUME EXPECTED INCREASE
AT 7 PERCENT, COMPARED WITH GROWTH WORLD TRADE, AT
5 PERCENT. IMPORT VOLUME IS EXPECTED REMAIN STAGNANT.
EXPORT PRICES ARE EXPECTED RISE BY 45 PERCENT; IM-
PORT PRICES BY 67 PERCENT.

7. JAPANESE EXPECT TO ACHIEVE TRADE ACCOUNT EQUILI-
BRIUM IN FIRST HALF 1975. SOME EDRC MEMBERS CONCERNED
THAT RAPID IMPROVEMENT IN TRADE BALANCE BY JAPAN MIGHT
WORSEN DEFICIT POSITIONS OF OECD OR NON-OIL LDC TRADING
PARTNERS, BUT JAPANESE CLAIMED IMPROVEMENT WOULD COME
FROM EXPORTS TOOPEC COUNTRIES, USSR AND CHINA. OTHER
EDRC MEMBERS WONDERED IF JAPAN COULD INDEED MAINTAIN
EXPECTED LEVEL OF EXPORT GROWTH WHEN DOMESTIC PRICES
WERE RISING SO RAPIDLY AND MAJOR EXPORT MARKETS RE-
COVERING SLOWLY.

8. MEDIUM TERM PROSPECTS: JAPANESE NOTED THAT
1973-77 PLAN AIMED TO SHIFT JAPAN FROM GROWTH ORIENTA-
TION TO WELFARE ORIENTATION. THIS PLAN WILL BE RE-
VISED IN FALL 1974 TO REFLECT CHANGES IN ENERGY SITUA-
TION AND HIGHER RATES OF INFLATION. REAL GNP AND
CPI BOTH EXPECTED RISE ABOUT 7 PERCENT PER YEAR FROM
1973 TO 1985. WAGES EXPECTED RISE 15 PERCENT P.A. AND
PRODUCTIVITY BY 6 PERCENT. SECRETARIAT NOTED THAT IT
WOULD NOT BE DIFFICULT PROBLEM TO CUT INVESTMENT RATE
AND NATIONAL SAVINGS RATE FROM RECENT VERY HIGH LEVELS
AND THUS FREE RESOURCES FOR PRIVATE CONSUMPTION AND
WELFARE EXPENDITURE.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC CONDITIONS, POLICIES, FINANCIAL DATA
Control Number: n/a
Copy: SINGLE
Draft Date: 09 JUL 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: shawdg
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974OECDP16663
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D740182-0415
From: OECD PARIS
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19740765/aaaacdme.tel
Line Count: 215
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators:
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: (A) USOECD 13971, (B) TOKYO 8555, (C,) OECD DOC
Review Action: RELEASED, APPROVED
Review Authority: shawdg
Review Comment: n/a
Review Content Flags:
Review Date: 22 APR 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <22 APR 2002 by shawdg>; APPROVED <25 FEB 2003 by shawdg>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: EDRC ANNUAL REVIEW OF JAPAN, JUNE 28
TAGS: ECON, OECD
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005